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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE strength of business during the Summer months has convinced even persistent skeptics that 1926 is destined to be another record year. The pessimists are now moving forward the hour for the culmination of their expectations to some time in 1927. The predicted slump did not come in the Spring, the mid-summer decline has been less than usual, and now all signs point to a heavy volume of business in the Fall. The Southwest has harvested a crop of wheat which with other favorable conditions practically assures the status of that region for the year to come. On the whole the prospect for farm products is that the combination of yields and prices will produce results rather more favorable to the producers than in any year of the last five. The July Bulletin of the Department of Agriculture says:

> With the stage set for strong hog prices well into next year, with prospects for wheat growers moderately good, with cattle "coming back" in the West and the dairy industry picking up in the East, it appears that this may well prove to be another season of improvement in agricultural conditions. An inquiry just completed by this Bureau, covering 15,330 farms in all parts of the country, indicates a net financial return last year of $1,297 per farm, as against $1,205 in 1924, $1,020 in 1923, and $917 in 1922.

The outlook for agriculture and the industries is reflected in the rise of stocks on the New York Exchange to near the high level of last Winter, with certain of the market leaders such as United States Steel and General Motors up to new high levels for all time. Notwithstanding the long period of sustained activity, no fundamentally unfavorable factors have appeared, and the conservative temper prevailing is one of the best assurances against the over-expansion which is fatal to prosperity.

All the familiar indexes give testimony to the high level of business. Bank checks cashed and railway traffic are exceeding corresponding figures for all previous years by a comfortable margin, electric power consumption, which has come to be regarded as one of the most trustworthy indexes of manufacturing activity, continues to establish new records, and employment conditions have been very satisfactory in most sections. The steel industry has had one of the best Julys on record in point of volume, prices have held at the firmer levels established in June, and earnings statements now coming out for the second quarter and the half year make a good showing compared with a year ago. With the principal consuming industries operating at high levels no immediate reversal of tendencies in this line is in prospect.

Output of automobiles fell off 10 per cent in June as compared with May, and was likewise somewhat below the corresponding month of 1925 for the first time this year, but the showing is good considering the large gains shown in previous months. Building maintains its extraordinary pace, the June figures showing new contracts awarded to be close to the levels of May this year and June 1925, while permits jumped in June to a 7½ per cent increase over last year. Demand for non-ferrous metals has improved and prices have shown a firmer trend. In the face of record-breaking production, stocks of refined and blister copper, as reported by the American Bureau of Metal Statistics, showed a decrease during June from 346,800 tons to 332,600 tons, or 14,200 tons, giving evidence of the high level of consumption, due in large part to activity in the electrical industry. During the first six months of the year the General Electric Company reported orders totaling 10 per cent more than in the corresponding period of last year, with orders for the second quarter showing a 19 per cent increase over that period in 1925.

In the textile industry, firmer raw cotton was accompanied by the most active market in print cloths and sheetings since last Fall, and cotton consumption continues to hold up to surprisingly high levels considering the widespread reports of curtailment. Whether, however, any permanent cure of the evident disproportion between productive capacity and consumptive demand in the industry can be effected without rather determined efforts to broaden the demand for cotton products remains somewhat doubtful, and announcement during the month of the formation of the Tex-

tile Institute by the northern and southern mills to study problems of the industry is evidence of a realization on the part of the leading interests of the need for cooperative action to that end.

In woolens, cloth manufacturers have cut prices 10 to 12 per cent on Spring 1927 offerings, and the National Council of Wool Manufacturers has announced a publicity campaign in hopes of stimulating a revival in the use of wool goods. Silks are still suffering from the over-production that took place this Spring, and linen imports are the smallest in a generation. Apparently the whole textile industry is facing about the same problem, namely, that of either damping down production to conform to a market that temporarily at least has been restricted by style changes, or of finding methods of building up consumption to a point commensurate once more with the productive capacity of the industry.

Agricultural Conditions

The Winter wheat crop is harvested, and according to the Government's July 1 estimate, will total 567,262,000 bushels, or 169,276,000 bushels above the final crop last year. The increase is mainly in the States of Kansas, Oklahoma and Texas, which had an acreage increase of about 20 per cent and a yield, according to the July 1st report of the Department of Agriculture, of 242,000,000 bushels, against 106,656,000 bushels last year. There is reason to believe that this July estimate is too low, as threshing reports show that the actual turnout is above estimates, the quality being excellent and the weight over-running.

The Spring wheat crop has not done so well, relative conditions as to the two wheat crops being reversed from what they were last year. The Spring wheat territory suffered from a lack of moisture, and the crop is uneven, the July government report estimating it at about 200,000,000 bushels, against about 280,000,000 bushels last year. It is understood that some improvement, as the result of timely rains, has occurred since this report was issued.

The wheat crop in Northwestern Canada has suffered from the same conditions which have affected the yield on this side of the line, and some reduction from last year's yield is expected. On the other hand the damage to the crop has affected the markets, Chicago prices rising approximately 20 cents per bushel from the low figures on the crop and then losing about one-half on the rain news.

The crops of Europe outside of Russia are good, but not so exceptional as last year, and inasmuch as the world carry-over this year was very small, the question whether supplies will be abundant or short depends again on the crop in the Southern hemisphere and the outcome in Russia. Reports from Russia are that this is a good year, but information of similar tenor was given out last year and never was followed by any grain. The markets will pay attention to the arrival of actual grain from Russia, but not to any reports about the crops. On the basis of the production of wheat in all countries from the three harvests of 1924, 1925 and 1926, the world is working on a very small margin of wheat supplies.

The corn crop had to contend with a cold Spring and with hot weather and drought in the Summer. The government report as of July indicated a crop of only 2,660,780,000 bushels, against an average of 2,848,000,000 in the last five years. The condition was the lowest for any July 1st on record, except in 1924. It is doubtful if the crop has gained on the whole since then, as the drought has been severe in some localities. The carry-over of corn will be above the average, because of the short supply of hogs in the past year. The government estimates that including the carry-over of both years the amount of corn available for the coming year will be 2 to 5 per cent less than last year. Since June 1, December corn at Chicago has advanced from 75¼ cents a bushel to 88¾ cents.

Oats were a big crop in 1925 and have been bringing low prices. This year's crop is smaller, but owing to the carry-over, prices thus far remain about the same.

The crop of flaxseed is estimated at about 20,000,000 bushels, against 22,000,000 last year and an average of 18,000,000 over the last five years.

The hay crop has suffered from drought in some localities. The barley crop is below last year's, but above the five year average. The rye crop is short, because of a reduction of about 12 per cent in the acreage and also a low yield. The rice crop is good, the Louisiana being estimated at 12 per cent above last year's. The fruit crops are described as "uniformly good." It is early for an accurate forecast of the potato crop, but the estimate is for a yield 8,000,000 bushels above last year's, but 90,000,000 below the big yield of 1924.

The general crop results support the view that there is a fair balance between the production and consumption of farm products in this country, and that on the average there is good reason for expecting remunerative prices for them. The situation in the corn belt in the past year has been abnormal by reason of big crops of the two chief feed grains, with a deficiency of live stock to eat them. This situation will be better in the coming year.

Livestock

Hogs continue to bring good profits to producers, though prices during July have gone off rather substantially from the high level of June. Supplies have been in liberal volume,

possibly influenced to some extent by the less favorable outlook for corn. Doubtless the corn-hog ratio has passed its crest, though with the Spring pig crop slightly below that of 1925 and stocks of pork and lard on July 1 the smallest in eleven years, no early decline in hog prices seems probable. An increase, however, of 25 per cent in the probable Fall farrowings, coupled with the somewhat less favorable outlook for feed supplies, is made the basis of a warning by the Department of Agriculture that prices may not be so favorable when the Spring 1927 pig crop is ready for market.

Cattle slaughtered under Federal inspection during the first six months of the year was the second largest on record for the period, while the combined cattle and calf slaughter was the largest for the period ever recorded. Despite this heavy slaughter, prices averaged above the first half of 1925, and were the highest since 1920.

Following is a table comparing the market value and weight of slaughterings under Federal inspection in the first six months of the past six years. Aggregate values of all livestock slaughtering in the first six months of 1926 were $56,275,000 more than in the corresponding period of 1925, and $262,667,000 greater than in the corresponding period of 1924. In the case of hogs alone the increase in value of marketings over two years ago was approximately $200,000,000. These figures have to be taken into consideration, along with grain prices, in calculating the return on agriculture during the past two years.

Market Value and Weight of Livestock Slaughtered Under Federal Inspection

Six Months Ending June 30, 1921-1926

Six months Ending June 30	No. of Head	Total Weight Lbs.	Average Cost per 100 Lbs.	Total Value
		CATTLE		
1926	4,704,659	4,560,873,813	$7.58	$345,885,458
1925	4,459,577	4,324,721,351	7.53	325,560,947
1924	4,278,769	4,107,937,830	7.22	296,648,996
1923	4,252,633	4,110,807,425	7.32	300,919,755
1922	3,900,904	3,919,181,320	6.82	267,127,227
1921	3,637,727	3,645,524,122	7.43	270,742,315
		CALVES		
1926	2,648,202	433,464,318	10.08	43,700,157
1925	2,688,989	431,052,186	8.85	38,147,756
1924	2,438,703	390,325,946	8.45	32,975,525
1923	2,271,078	350,083,693	8.63	30,195,542
1922	2,114,867	315,625,405	8.45	26,662,374
1921	1,998,180	303,136,542	9.12	27,656,290
		SHEEP AND LAMBS		
1926	6,223,479	520,832,383	13.28	69,152,866
1925	5,870,249	488,964,988	14.64	71,566,740
1924	5,657,921	463,858,232	13.24	61,413,731
1923	5,681,470	470,556,489	12.35	58,102,127
1922	5,206,708	420,921,032	12.30	51,761,424
1921	6,243,178	519,525,669	9.18	47,699,413
		HOGS		
1926	21,079,107	5,021,997,750	12.76	640,866,828
1925	23,679,243	5,223,682,858	11.64	608,056,166
1924	28,092,269	6,250,904,371	7.13	445,896,607
1923	27,009,496	6,135,106,157	7.86	482,390,296
1922	21,523,056	4,850,402,603	9.77	474,110,729
1921	21,088,973	4,754,596,541	8.93	424,629,009

Despite low prices of corn, cattle feeding operations have been generally unsatisfactory, due to high prices of feeders, which is the reverse of the situation a year or so ago. With the heavy over-supply of corn and a shortage of cattle, cattlemen have been trying to expand their feeding operations until they have bid up feeders to where they are nearly on a par with fat cattle, which of course is unsafe. Like the manufacturers of cotton goods they have been paying too much for their raw material in view of prices for the finished products. The cotton goods people blame the speculators in raw cotton who operate on the cotton exchanges, but it is not clear that the cattle-feeders can shift the responsibility to anybody. Nevertheless, the Department of Agriculture expresses confidence in the cattle outlook, as shown by the following quotation from the Department's July Bulletin:

> There are many indications, however, that there may be a rather sharp falling off in the marketings of both cattle and calves during the second half of this year. The situation in the producing areas of the West and Southwest, both physically and financially, is much better than a year ago. There is much evidence of returning confidence in the business, and forced liquidation is ended. Prices of breeding cattle show considerable improvement over last year. While there is little indication of a tendency to expand production, it is possible that marketings this fall will be more in accord with yearly production than for four years past, when they have greatly exceeded this.
>
> Any material reduction in marketings during the next six months may be expected to result in a rather sharp advance in cattle prices, for the underlying position of the market seems strong. The extent of this advance will depend somewhat upon the corn situation in the feeding States. Another good corn crop and continued low prices of corn, with hog numbers indicated as but little larger, should result in a big demand for unfinished cattle since the heavy marketings of the past six months have depleted the supplies of such cattle in the feeding States to the lowest point in five years.

Similar views regarding cattle prospects were voiced by Chairman McClure, of the Kansas City Federal Reserve Bank, in an address on July 22 before the Better Beef Conference at Kansas City. We quote from Mr. McClure as follows:

> Now, as to the financial condition of the cattle business. I mentioned before that conditions were good now. When we had what were called "hard times" your business did not prosper. It appears now that there has been such an improvement in this respect that your business will prosper, and in fact all this southwestern cattle and agricultural country is in good financial condition at this time, with prospects good for the future. Grazing has never been better all over the cattle breeding country. The farmers have had a great crop of wheat. This ought to put the banks in splendid condition and remove most of the frozen assets that have been troubling many of them since 1920. Financial conditions were much better in 1925 through the territory named, and with the great Winter wheat crop now being marketed we can predict an easier money situation from now on.

Commenting on the effects of the large wheat crop harvested in the Southwest on business and money conditions of that district, Mr. McClure goes on to say:

> We are now feeling the effects of the large wheat crop, and liquidation of loans is taking place very

rapidly and bank deposits are increasing. The Federal Reserve Bank during the first five days of July received payment of 1,282 notes held by it under rediscount from member banks that were paid before maturity and returned rebate of interest to them of $55,000.

Cotton

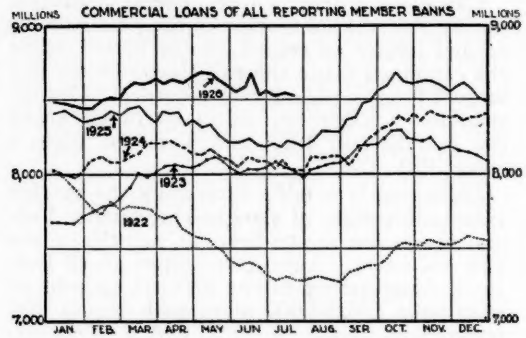
Cotton is not yet far enough along to give a trustworthy idea as to the final outturn, but on the basis of indications at the middle of July the Government forecasts the crop at 15,368,000 bales, a decline of 267,000 bales from the July 1 forecast, and of 718,000 bales compared with the final yield last year. Favorable facts regarding the crop are the acreage, which is the largest on record, and the early indications that weevil enfestation may be light, while unfavorable factors are the lateness of the crop and the poor fruiting of a large part, due to bad weather and the depredations of the hopper flea. What the final yield will be depends largely on weather conditions during the next few weeks. Should developments during the remainder of the season be as unfavorable as in 1921, 1922, and 1923 the total production would not run above 13,476,000 bales, while conditions as favorable as existed in 1924 and 1925 might run up a total of 16,628,000 bales. With continued rainy weather in the belt during the last part of the month, an improved demand from domestic mills, and a better showing as to exports, which on July 23 showed a loss of only 174,841 bales for the crop year compared with a year ago, compared with a difference of approximately 400,000 bales at one time during the year, the market has found much better support, and spot at New York shows a rise from the low of 17.85 cents on July 12 to 19.20 cents by July 27.

Money and Banking

Accompanying continued active business conditions, seasonal demand for funds for moving the wheat crop, and some increase in stock market requirements, money has tended to be firmer in July. Stock market time loans have moved up from 4¼ to 4⅝ per cent for 90-day loans and from 4¼ to 4¾ per cent for six months money, while the commercial paper market is from ¼ to ⅜ higher than a month ago. Call loans, on the other hand, continue relatively easy, the rate, after firmness early in the month, dropping back to 4 per cent.

The volume of brokers' loans, according to the latest figures available, has increased about $200,000,000, or 9 per cent, since the low point of the year reached in May, but is still $520,000,000 below the levels of February. This would appear a not excessive increase in view of the marked rise in stock prices to levels close to the highest of the year, but perhaps a better index of the volume of securities carried on credit are the total loans on stocks and bonds of the weekly reporting member banks in principal cities throughout the country. These figures, which include brokers' borrowings and also loans direct to individuals on stock market collateral, are close to the high levels of the Winter.

Commercial loans of the reporting banks are following about the normal course for the season, as shown by the accompanying diagram which compares the figures each week for five years. Except for a temporary advance around the middle of June the tendency has been gently downward, but we are now approaching the season of the year when an increase may be expected.



It will be observed that the spread in the figures this year over last year has grown progressively wider as the year has advanced, which would seem to preclude much chance of easier conditions.

Outlook for Money

In general, the money situation appears to be in pretty fair equilibrium, with the probability of moderate advances in rates as demands for crop moving and Fall trade pick up. An interesting development late in the month was the shipment of approximately $1,000,000 in gold to Canada, following the rise of Canadian exchange to a premium. This movement reflects a favorable trade balance in Canada and heavy financing recently done in New York. Further shipments are not improbable when the Canadian crop movement gets under way, if not before. Such movements frequently occur in the Fall when Canadian grain is moving, the amount of gold so shipped in October and November of last year approximating $36,000,000 net, all of which came back during the early months of this year.

To a large extent, of course, the movement of money rates will be influenced by the policy pursued by the Reserve banks. In 1923 the liquidation of securities by the Reserve banks in the Spring contributed materially to the firmness of the money market in the Fall of that year, and conversely the purchase of securities through the Spring and Summer of 1924 were a factor in the easy money condi-

tions in the latter part of that year. Analysis of the present financial situation reveals an expansion in the loans and investments of the principal member banks of the Federal reserve system, amounting to nearly a billion dollars, or about 5 per cent, founded on an increase of approximately $100,000,000 in Federal reserve credit outstanding and net gold imports of $90,000,000. Over a long period of years the average annual expansion of bank credit required to finance the country's continuously growing volume of trade has been between 6 and 7 per cent, so that the increase during the past year has been within the normal limits. Barring unexpected developments, this would suggest the improbability of any major change in Federal reserve policy, leaving the seasonal requirements and demands resulting from active business as the probable major factors in the Fall money market.

The Bond Market

After several months of steadily rising prices, the bond market during July settled into a period of mid-summer inactivity. New offerings were small in volume but their ready absorption indicates that the supply of investment money remains undiminished. Slight price recessions during the month were due more to a temporary let-up in the selling activity of bond dealers generally and to the disinclination of investors to take immediate action than to any weakness in the fundamental situation. Time money rates have shown a slight hardening tendency with the continuance of business activity, but there is nothing in the situation to indicate that credit demands during coming months will withdraw any substantial volume of funds from the investment field. There is little evidence of bank liquidation nor is it likely that banks will sell any substantial volume of their security holdings so long as the temporary credit demands from their clients can be met through the rediscount facilities of the Federal Reserve System.

The Dow Jones average for forty listed Domestic corporate issues, (10 high grade rails, 10 second grade rails, 10 industrials and 10 public utilities) on July 26th was 94.87 as compared with 95.22 on June 25th and 92.29 on July 25th a year ago. This combined average of the four groups, however, is not a fair index of the trend of the market as a whole because the market on both municipals and foreign dollar bonds, neither of which are included in the above average, was much better maintained than that on the other groups. The most substantial declines occurred in the lower yield corporate issues such as are particularly suitable for institutional investment. Most high yield securities were fairly active and relatively free from pressure.

United States Government Securities

The slight recession in Government bond prices during the month would seem to indicate that the impetus given the market late in June by the payment of approximately $334,000,000 Treasury Certificates out of current Government receipts had possibly carried Government bond prices a bit too far. Then, too, the hardening in time money naturally had its effect upon the Government bond list which is always fairly sensitive to current interest rates. Another retarding influence was the substantial liquidation of Liberty 4¼s by individual investors who had been holding such bonds because of the exemption from surtaxes on holdings up to $50,000 which they had enjoyed previous to July 2nd. Such funds were switched in large volume during the month to totally tax exempt securities or to taxable bonds which offered a higher net yield than can be obtained from the Liberties since their tax exemption privileges have been reduced. This surtax exemption was the one feature which previously had made the Liberty issues of particular appeal to individual investors with substantial incomes, and now that this advantage has been pretty largely removed, the Liberty bond market is becoming more strongly institutional than ever.

Municipal Bonds Steady

The strength of the municipal market was due in a measure to the buying support coming from several large American fortunes released from active industry during recent months and also to the absence of any substantial volume of new offerings. While many dealers report a good supply of bonds on hand, the volume on their shelves is not growing and, in view of the scarcity of prospective new issues, the possibility of any substantial decline seems remote. The current softness in corporation bonds is of course a retarding influence on present municipal prices. The most promising factor in the municipal situation today is the prospect of a substantial reduction in the volume of forthcoming new issues. For several years past any appreciable advance in municipal prices has always had to meet the pressure of a growing volume of new offerings. The month of May of this year marks the first reduction of any significance, new issues during that month being about $50,000,000 less than during the same month of 1925. The June total was about equal to the total for June a year ago but the small amount of new issues now visible indicates that the volume for July and August will be substantially reduced. The temporary reduction in investment buying means that institutional and other investment funds scheduled for the municipal field are accumulating and will become a strong factor as soon as activity is resumed.

New Financing During the Half-year

The progress of new financing during the first six months of 1926 is shown in the table below giving comparative figures for the first six months of 1926, 1925 and 1924, respectively.

	(Six months' period ended June 30th) 1926	1925	1924
Municipal Bonds (Cities, Counties and Municipalities)	$730,938,337	749,907,851	830,779,456
Railroad Bonds	227,836,000	329,619,500	414,275,000
Public Utility Bonds (Issues of $500,000 or more)	961,584,200	875,875,300	594,285,000
Industrial Bonds (Issues of $1,000,000 or more)	1,158,558,760	945,030,350	418,021,200
Foreign Bonds	384,197,000	360,231,000	331,090,000

Long term municipal financing for the period has shown a slight shrinkage from previous years. The 1926 figure, however, is swelled by a single issue of $75,000,000 City of New York Bonds. New municipal issues, visible or in prospect, for the remainder of the year indicate that the total for 1926 will show a considerable reduction. New railroad financing for the half year diminished substantially, being approximately $100,000,000 less than for the same period of 1925 and only slightly more than half the volume for the six months of 1924. New public utility issues showed a substantial increase, as might be expected with the tremendous development of the industry and the tendency towards consolidation and unification. The market for sound utility securities is a constantly improving one as is evidenced by lowering coupon rates and the growth of legalization for a savings bank investment. The six months period of 1926 set a record for volume of industrial financing in this country, both from the standpoint of number of issues and gross amount of securities offered. The next highest industrial total for a like period occurred in 1923 when $948,825,000 of new securities were issued. Of the total foreign financing for the first six months of this year 54½% went to Europe and 45½% to Latin America, and of European financing about 73% went to Germany. The three salient features of foreign financing in 1926 appear to be, first: the domination of German and Latin American loans, second: the progressive increase of corporate loans as contrasted with government and municipal issues, and third: the great increase in the number of small issues.

European Affairs

Industrial conditions in Europe have undergone no great change in the first half of 1926. They have not been as good as in the first half of 1925, but this does not mean that economic recovery has been definitely halted. In the last named period Europe was under the stimulus of new confidence, inspired by the inauguration of the Dawes plan, the settlement of the reparations dispute, the establishment of a sound monetary system in Germany, the resumption of gold payments in Great Britain and Holland, and other encouraging developments incidental to these. The revival which followed set a faster pace than could be maintained, for while these accomplishments were fundamental they did not provide all the conditions necessary to prosperity. They did not of themselves restore reciprocal relations between the industries or populations of Europe, without which there cannot be full employment or normal consumption.

Depreciating and Appreciating Currencies

The depreciating and appreciating currencies have been harmful to trade by the confusion they have caused in wage and price relations. A depreciating currency reduces real wages by a gradual and silent process that is almost unnoticed for a time, so that a considerable reduction may occur before a compensating readjustment of wage rates is made. Prices are affected in like manner. Instead of rising promptly to compensate for the declining value of the currency they respond slowly, thus falling below prices in gold standard currencies.

The iron and steel and textile industries have been notably affected, because their products enter largely into world trade and consumption in these lines is not up to par. Belgium and France undersell Great Britain, Germany and the United States, because foreign buyers are able to convert their funds into French and Belgian currencies advantageously, while French and Belgian costs and prices have not increased in corresponding degree. Canadian iron and steel producers recently have appealed to the new Advisory Tariff Board of the Dominion for special customs duties to protect them against importations from countries with depreciated currencies, referring to France and Belgium.

Of course this apparent advantage to a country from the falling value of its own currency is temporary and deceptive. The country is selling its products and labor for less than they are worth, usually without knowing it. The people of Germany went all through that experience and want no more of it, although complaining now of loss of business to Belgium and France. The Committee of Experts appointed to advise the French Treasury, in its recent report, says that "the French people are working and producing, but most of them are being impoverished unconsciously."

The British Situation

On the other hand, an appreciating currency carries up wages and prices in purchasing power and in terms of foreign currencies, unless readjustments are made, and this disturbs trade relations. Thus in Great Britain from the beginning of 1925 to the beginning of 1926 the general wholesale price level declined about

10 per cent and the cost of living as calculated officially declined about 5 per cent, mainly as the result of raising the currency to the pre-war parity. The decline in the one case was greater than in the other because wages are a smaller factor in wholesale prices than in retail prices, and wages yield more slowly than any other factor in prices. Eventually the readjustment probably will be practically uniform, but at present the situation is that British prices in competitive lines are forced down while costs have not declined in like degree. The purchasing power of British wages is tending upward, but British employers have failed almost wholly to get wage concessions on this account. About 25 per cent of the coal production of Great Britain is sold for export, and now must be sold at a lower nominal price, although in currency of higher purchasing value. The miners are contending for the same nominal wages as they had last year, but if account is taken of the higher value of the currency this would mean higher wages. In the present state of the industry the margin of profit is too small to stand it, hence the shut-down. Thus what should be only a readjustment of wages and prices to a change in the value of the currency, without in the long run affecting the standard of living, becomes the issue of a great industrial controversy.

Norway and Denmark

Norway and Denmark have been suffering like Great Britain from the appreciation, rather than depreciation, of their currencies. Owing to general confidence that their currencies would be eventually restored to par, speculation for the rise has caused a more rapid rise than either government desired, and this, of course, has been reflected in a fall of internal prices. This called for a downward readjustment of wages and the usual difficulty has been experienced. In the case of Denmark the currency is now restored practically to the old par, and according to an official statement, the gold standard will be definitely reestablished on this basis. The restoration has been a drastic experience, but the worst is now over. In the case of Norway the government is endeavoring to reduce fluctuations and hold the currency at about 21 cents to the krone, the old par having been 26.

Gold Standard Generally in Effect

A majority of the countries of Europe are back upon the gold basis. It is safe to say that Great Britain, Holland, Germany, Switzerland, Austria, Hungary, Czechoslovakia, Sweden, and Finland are firmly established. None of them have any thought of getting back into the slough of inflation for any apparent temporary gain. Latvia, Esthonia and Lithuania also are on a gold basis. The Russian chervonetz currency, after being firmly maintained for several years, is reported to be unstable, as the result of disappointing exports last year, but Russia is not a competing country at present.

These exchange troubles, although increasing present trade difficulties, are temporary. The exchange situation has been bad ever since the war, but gradually currency systems have been reconstructed until the area of disorder has been largely reduced. France is now the center of the disturbance, but the Belgian and Italian currencies are involved, and price instability in the three countries exerts a depressing influence upon many industries throughout Europe. Poland has been experiencing a combined political, industrial and monetary crisis, and naturally has not been a very good field for trade. Just now her coal industry is having a stimulus from the cessation of British shipments to Baltic and Mediterranean ports. An expert commission is working on the monetary system, and with a good crop this year there is reason to believe that the country will overcome its present troubles and succeed in establishing the gold standard.

European Trade Relations

As already intimated, these exchange complications are more important because the volume of international trade is less than normal—much less than it would have been with a normal increase since 1914. War, inflation, deflation, exchange fluctuations, heavy taxation, scarcity of capital, the disastrous exploitation of the middle class, which had its savings in mortgages or bonds, national boundary changes, tariff changes, unbalanced price-relations—this list of troubles is enough to account for trade not moving freely in Europe.

Tariff negotiations are the chief political activity in Europe at present, and more considerations enter into them than at first appear. Each country is interested in gaining access for its products to other markets, and in keeping foreign products from competing in its own markets; moreover, the budgetary and trade equilibriums are matters of very great concern. There are the problems of getting revenues enough to cover governmental expenses and exports enough to cover imports, both achievements being necessary to currency stabilization. If revenues do not meet expenses and the Treasury borrows of the Central bank, the volume of currency is increased and signs of inflation appear, while if exports fail to meet necessary payments abroad the demands for foreign exchange either cause a drain of gold or lower the value of the domestic currency in terms of foreign money. As none of the countries want to lose gold, and under present conditions securities do not move readily, attention is concentrated upon stimulating exports or restricting imports until the trade situation is in balance.

Tariff Negotiations

Inasmuch as tariff negotiations are a bargaining process, preparations for them usually include a boosting of rates with a view to making concessions later on. Europe has been passing through this unsettling experience. It was inevitable, but no doubt some degree of stability will be reached eventually, and when business knows what to count on it will adapt itself to the conditions. Tariff policies are influenced not only by intense national feeling, and a desire in each country to be economically independent so far as possible, but by a feeling of uncertainty about markets for exportable products. The effect is to cause the countries to make things for themselves which they could buy more cheaply by exporting products better suited to their natural resources. Thus Italy is developing a primary iron and steel industry, although she has no coal and her iron ore resources are quite limited, because her national leaders feel a necessity for reducing importations to the lowest possible point.

This policy when followed by numerous small nations results in a general increase of industrial costs, for raw materials and living necessities are often included in the tariff lists. Czechoslovakia is not self-supporting as to foodstuffs, and has imposed a duty upon grain imports, against which the wage-earners recently staged an enormous demonstration before the parliament house in Prague. They insist that a tax on food shall be compensated in the wage rates. On the other hand, in all the countries of Europe the farmers claim that manufactures are on a higher price-level than their products, as the result of tariffs.

Although herself complaining of hostile tariffs all over the world and especially in Europe, Germany has raised her import duties generally in the past year, except as modified by treaties. An increase in the duty on wheat has been bitterly opposed by the working classes, but is defended, partly as necessary for the relief of agriculture and partly by the argument that Germany can become self-supporting as to the grains by stimulating the use of synthetic nitrogen, the production of which was greatly developed during the war. It is urged in defence of the tariff policy that Germany is under the necessity of establishing an excess of exports over imports in order to make the reparation payments.

Tariff Sentiment in Britain

Great Britain is suffering at least a temporary loss of markets in countries which formerly bought largely from her, and also a loss of trade at home by an invasion of foreign manufactures from countries which have tariffs against British goods. There results no little pressure for modification of her free trade policy, supported by the argument that the home market is the only sure market, and that if other countries refuse to exchange products Britain will be obliged to develop a larger degree of self-sufficiency and greater trade within the empire.

However, she is not yet ready to accept this argument without qualification, for her stake in foreign trade remains too great. When the iron and steel industry recently applied for protection under the "safeguarding of the industries" act the decision was that a tariff on iron and steel would raise prices in England and place all British industry on a higher cost basis, with results too serious to be contemplated.

Volume Production

These conditions in Europe make an observer more appreciative of the great area for unrestricted trade within the United States, where nobody bothers about the trade balances between the states or thinks of them as requiring attention. They take care of themselves, and we scarcely realize the extent to which our wonderful industrial development is due to this unified trade area.

It is an established fact in industry that volume production is a fundamental requisite in economical production. Much has been written about the success of American manufacturers in obtaining low costs by paying high wages, and it is true that they have furnished a very striking object lesson that high wages and low costs may go together. It is obvious, however, that volume production is an indispensable condition, and for this there must be an ample market field. The small countries do not have it within themselves, hence more and more talk about a United States of Europe, which unfortunately is a dream rather than a prospect.

The French Financial Crisis

The French monetary crisis of the past month has not been of sudden development. The conditions which produced it have been shaping for a long time. That portion of the depreciation of the franc chargeable directly to the war effort may be considered unavoidable, for inflation always accompanies war. It was impossible for France to raise money by the ordinary means of loans and taxation fast enough to meet the war demands on the Treasury, and the Government leaned heavily for ready funds upon the Bank of France, a semi-public institution which for more than one hundred years has issued the currency. After the war the necessity for reconstruction expenditure seemed to be almost as imperative as the demand for war expenditures had been, and for this purpose and to meet the general Treasury deficits the public debt has been approximately doubled since 1918.

Although taxation has been constantly increased in recent years and is now very heavy, particularly upon incomes readily reached, the government probably was not as prompt in levying new taxes, or as prudent in limiting expenditures for reconstruction, as it would have been if it had not expected that the latter outlays would be covered by reparation payments. The reconstruction expenditures were met in the main by bond issues, sold to the French public, but unfortunately these issues were of short maturities, and are now falling due, creating one of the Treasury's most difficult problems.

This course of finance came to an end when it became apparent that reparation payments would not meet the indebtedness being created in anticipation. The Dawes Committee set forth the bare facts of the reparations situation in the Spring of 1924, and a crisis in French exchange developed about that time, which was stayed by the credit for $100,000,000 negotiated in New York. Confidence in the ability of the Government to stabilize the situation was restored for a time, but it was evident that inflation and the increase of indebtedness must cease. Interest on the debt was absorbing more than one-half the annual income of the Treasury.

The Premier, M. Poincaré, rose to the situation with vigor, proposing a general and pronounced increase of taxation. He carried his measures through the Parliament, but the public did not as yet understand the gravity of the situation, and in the election which followed, in May, 1924, the socialist groups in the Chamber of Deputies gained considerable numerical strength, with the result that M. Herriot, a socialist leader, became Premier. He has to his credit the Dawes plan settlement, but his financial policies did not inspire confidence, and maturing Treasury obligations began to be presented for payment instead of for renewal.

Pressure on the Treasury

This was the beginning of the Treasury's troubles with the floating debt. Demands for cash payments meant that the Treasury must resort to the Bank of France. Soon after the end of the war the management of the Bank had begun urging that the advances to the Treasury should be reduced, in order that the Bank might have more of its resources free for its regular commercial business. The Government recognized the propriety of this and agreed to make a substantial reduction in every following year. It did so for several years, with funds derived from current bond issues, but under the pressure of the Government's necessities, and as a result of the disinclination of the public to buy more bonds, the advances have risen from 23,000,000,000 francs in 1923 to over 38,000,000,000 at the present time.

Since the fall of the Herriot ministry early in 1925 events have moved rapidly. M. Herriot was succeeded by M. Painleve, with Joseph Caillaux as Minister of Finance. Caillaux attempted to relieve the pressure on the Treasury by a bond issue in which holders were given a guaranty against currency depreciation, but the offering met with a disappointing reception. His mission to the United States to settle the war debt was unsuccessful, and he resigned soon afterward. M. Painleve was succeeded as Premier by the veteran statesman, M. Briand, who held the post until he met the adverse vote on the 17th of last month. From the beginning of 1925 to this time nine finance ministers had tried their hands at devising financial plans and retired, having failed to secure the support of the Chamber of Deputies.

In April last, under the skillful guidance of M. Peret, then minister of finance, a new revenue measure was piloted through the parliament, which was calculated to bring the budget into balance. This seemed to be a substantial gain, but dissensions were evident which deprived the action of much of the effect it might have had, and the franc continued to decline.

A Committee of Experts

At the instance of M. Peret, a strong Committee was instituted, consisting of 13 eminent French bankers and economists, to act in an advisory capacity to the Treasury. This Committee, after about six weeks of careful examination into the Government's finances and the general economic conditions, submitted an excellent report, in which all phases of the subject were treated with candor and wisdom. It advised more taxation, the creation of a sinking fund for the floating debt, under independent administration and supported by certain definite revenues, including the proceeds of the tobacco monopoly; also that early steps be taken upon a program for stabilizing the currency and the resumption of gold payments. The Committee further advised the ratification of the debt settlements with the United States and Great Britain and the negotiation of foreign credits to support the proposed policy.

By the time this report was ready M. Peret had become impatient or discouraged over the attitude of the Chamber, and resigned. Joseph Caillaux now took up the task again. He adopted the Committee's recommendations with some reservations, but announced that he must have a free hand in dealing with the situation, and asked blanket authority from the Chamber. M. Briand supported him in this request, and upon this issue the ministry fell.

The unfavorable vote was very much mixed as to the sources from which it came, a conservative element of considerable strength joining with socialist groups in refusing to grant blanket authority.

The socialists however furnished the bulk of the opposition and M. Herriot was in line for the premiership again. He was invited by the President of the Republic to form a cabinet and complied, but the public plainly had no confidence that financial reform would come from that quarter. The franc exchange rate for the dollar, which at the beginning of the war was 19.3 cents, at the beginning of 1926 about 3.75 cents and on May 1st about 3.30 cents, now broke to approximately 2 cents. The opposition to Herriot was so pronounced that the Chamber of Deputies refused to give him a vote of confidence and he stepped down.

He has been succeeded by M. Poincaré, who has the confidence of the business community, and who has undertaken to meet the emergency by forming a union Government, inviting into it representative leaders from all the principal groups, excepting the Communists. Including the head, this Cabinet contains six ex-Premiers, M. Herriot among them. Under ordinary conditions it would appear that such a cabinet would be incapable of harmonious action, but if these leaders cannot agree upon a policy it is useless to hope that the parliament will be able to deal with the situation. The acceptance of these individuals implies a willingness to make an effort for co-operation.

Parliamentary Dissensions

The fundamental difficulty in dealing with the monetary situation has been that the problem was essentially one for experts, and that the parliamentary body has refused to take the advice of experts. The problem is an economic one, but it has been handled with all the passion, prejudices and suspicions which characterize the treatment of economic questions when they get into politics. The French parliament is made up of a dozen or more groups or blocs, and any ministry dependent upon a coalition of these for a working majority is in the position of having so many masters that its liberty of action is very closely limited.

M. Briand, facing the Chamber of Deputies two months ago, protested against the position in which he found himself while attempting to deal with intricate financial questions of great importance to the country. He was reported as follows:

> It was fragility of Government, he said, which constituted the most grave danger in the situation. As its chief he could not consent to live under a constant menace, suspended by a single thread. No Government so threatened from day to day, he declared, could take any great responsibility.
>
> Passionately he pleaded for union above all the usual little party combinations, for the victory of the franc, in which the rich and poor are alike interested.
>
> If the Government is not capable of winning this momentary union then it had better go, for the present uncertainty is the worst thing possible. If there is here another majority with another fiscal policy than that we are attempting let it show itself and take on its responsibilities. What we cannot tolerate is that our existence should be disputed every day.

This explains his request that the parliament grant authority to the ministry to deal with the situation and stop challenging its authority at every step. Apparently he considered it impracticable to attempt to deal with the complicated problem otherwise.

The socialistic groups in the Chamber are strong and with their theories of class exploitation they naturally have little use for the advice of financiers. They are strong for coercive measures aimed at the rich, and their proposals usually have had the effect of increasing the general state of alarm and confusion.

Suspicion of Foreign Loans

Among some of the legislators apprehension is evident that foreign capitalists are seeking to get a strangle hold of some kind upon France. They even suspect that the currency is manipulated from abroad to force them into a foreign loan. The Dawes plan is mentioned as a form of foreign oppression which may be proposed, although it is not quite clear why the Dawes plan should be viewed in that light by the French. It was devised as a practical agreement under which a state of disorder ruinous to all parties concerned might be cleared up. It is noteworthy that France receives 52 per cent of the Dawes plan proceeds and that the Germans prefer the plan to the conditions from which it rescued them.

Well-informed people know that the continued depreciation of the French currency has been deplored in all countries as a demoralizing factor in world trade, and that the financial centers would be glad to aid in the reestablishment of a sound monetary system for France, as they have given aid in like manner to Germany, Austria and other countries, when solicited to do so. They would be subject to censure if they refused, under proper conditions. The benefits of such transactions as the stabilization loans are mainly to the borrowing countries, but all the world gains by the restoration of order in monetary affairs. There is no more propriety in the use of the word "enslavement" in connection with such loans, or any international loans, than in the case of loans between individuals living in the same country.

These loans represent the transfer of capital for beneficial use and it goes without saying that definite terms of payment are agreed upon. Inasmuch as forcible collection is wholly out of the question, it would seem that lenders who place their capital with strangers

in foreign lands are quite as much at the mercy of the borrowers as the latter are at the mercy of the lenders. If the free movement of capital between countries makes for world progress and the general welfare, the use of language calculated to create international antagonisms on the subject is wholly out of place, and particularly so when coming from people who make such benevolent professions as the socialists do.

It need not be thought strange that French finance is disordered in view of the fact that so large a proportion of the legislative body is composed of individuals whose minds are fundamentally disordered on this subject. The principal cities of France are largely represented by socialists, and in every country in Europe the influence of this element has been for improvident and impractical financial policies.

The Currency Situation

The Bank of France before the war was one of the strongest and most conservatively managed of the issuing banks of the world, and it has continued to be conservative in so far as the policies were under the control of the bank officials, but although a privately owned institution its relations with the State have compelled it to respond to the Government's necessities. A government must meet its obligations in ready cash and when receipts from taxes and public loans are insufficient the Treasury inevitably falls back on the bank of issue. In this way the currency has been inflated from 6,683,000,000 francs outstanding in July, 1914, to approximately 54,000,000,000 francs at the present time. Gold in vault amounted to 4,141,000,000 francs in 1914, against 3,684,000,000 francs at the present time. Advances to the State increased from a nominal sum in 1914 to 23,000,000,000 francs at the end of June, 1924, and approximately 38,500,000,000 francs at the present time

This increase in the volume of currency of course has resulted in even greater diminution of its value, but until recently the French authorities have refused to consider that the depreciation was anything but temporary. All of the internal indebtedness is payable in this currency and it has seemed to the French people impossible that as victors in the war their money, and their savings in the form of public and private obligations, might go the way of the German and Austrian monies and obligations. The hope has been generally entertained that by a gradual appreciation the franc eventually might be restored to its pre-war gold value.

The report of the Committee of Experts is the first authoritative utterance in France to the contrary. It frankly recognizes what economists and financiers outside of France have been saying ever since the war, that the restoration of the franc to the pre-war value would involve too great a change in economic relations to be possible. The outstanding public and private indebtedness never could be paid on the basis of the franc at 19.3 cents and, furthermore, the greater part of this public and private indebtedness was contracted with the franc much below that value. The committee suggested that the currency be re-established on the gold basis at a new rate, somewhere between the current exchange rate with gold currencies and the current value in internal trade. It insisted that the essential thing was not the restoration of value in the currency, but stabilization to save what value remains and to provide a serviceable currency for the country's business.

Effect of Currency Deflation Upon the Debt

With this practical view adopted the problem is very much simplified. With the franc revalued according to the suggestion of the Committee, the burden of the internal debt will be so reduced that in proportion to the wealth of the country, and increased productivity of industry, it will be only moderately greater than the pre-war debt. The internal debt was about 33,000,000,000 francs before the war and now is about 290,000,000,000, the increase being slightly less than 9 to 1. On the other hand, the current value of the franc in the gold exchanges is about one-eighth of its pre-war value, which would make corresponding capital valuations eight times what they were in 1914. This means that the increase in the debt resulting from the war and reconstruction has been practically met by a capital levy on the Government's creditors, and of course the creditor class in general has suffered in like manner. It is useless to consider such losses, however, in connection with the rehabilitation of the currency. The latter is the subject of supreme importance at the moment.

The rate at which the franc should be fixed will depend upon how soon action is taken, because the internal value is still falling, (in other words internal prices are still rising), and there is danger of more inflation. It is undesirable to fix the new value at a figure which would make internal prices above the world's level, for that would affect the exports unfavorably, force lower prices and cause industrial troubles, all of which would make the transition process more difficult. On the other hand, the rate should not be such as to make internal prices unnecessarily low, because if the subsequent rise to the world level is very great the effect will be to make money unduly tight, and possibly produce a disastrous reaction. Moreover, such a valuation would inflict unnecessary losses upon the creditor class, whose losses will be deplorably large at best.

Available Gold Reserve

Fortunately the Bank of France has in its vaults a large gold reserve, the third largest in the world. It compares with the reserves of the Bank of England and German Reichsbank as follows, reducing all to dollars:

Bank of France	$736,000,000
Bank of England	744,000,000
Reichsbank	475,000,000

Population, total volume of business and volume of international transactions are larger in the case of both the other countries than in the case of France. London is a more important international center than either Paris or Berlin, and it is international requirements which make the heaviest demands upon gold reserves. Aside from temporary conditions there is no need for France to have larger reserves than Great Britain or Germany.

The Bank of England reserve by its statement of June 30 was about 49 per cent against note and deposit liabilities, the Reichsbank reserve about 39 per cent.

The circulation and deposits of the Bank of France on July 1st aggregated approximately 57,000,000,000 francs, and if a new gold unit was adopted, of, for example, one-seventh the contents of the present gold franc, the gold reserve would amount to 25,760,000,000 such units. If a currency corresponding to the new unit was authorized, and substituted for the outstanding franc currency, the Bank would have a reserve of 45.19 per cent against its note and deposit liabilities.

There is no reason to think that the ordinary run of payments in her international relations would give France any trouble. Her position is better than that of Germany, considering the latter's obligation to make reparation payments and that France will receive the larger part of such payments. Tourists' expenditures in France also are an important factor in the international settlements.

It would appear therefore that the Bank of France already has ample gold to carry the outstanding volume of notes, provided a new gold unit is created of about the present value of the paper franc. It would be essential to the success of any new system, however, that there be no further inflation.

Continuing Danger of Inflation

Inflation results from two causes: (1) an unbalanced budget, (2) redemption of maturing indebtedness. In either case the Treasury is in want of cash and obliged to apply to the Bank of France for aid, which is given in the form of additional currency, and enters into circulation.

The budget was practically balanced last Spring, but since then the currency has suffered serious depreciation and as a result of the rise of prices governmental expenses are increasing. Advalorem taxes will produce increasing revenues, but only about one-third of the revenues are on this basis, hence the equilibrium of the budget probably has been disturbed. The Committee of Experts has advised additional taxes and changes in the revenue laws to make the yield of the taxes more responsive to the rising prices.

The budget deficit is no longer the most difficult problem. Undoubtedly it can be handled, if dealt with positively and courageously. This is a question of executive competency, provided the legislative body agrees that the expenses of government must be covered by revenues and does not confuse the situation by impracticable experiments in taxation. The situation is too critical for inexperienced financiers or the exploitation of new theories. In the words of Professor Rist, of the University of Paris, an eminent economist and a member of the Committee of Experts, "Every form of financial impracticability should be renounced."

Distribution of Taxation

The entire system of taxation probably needs revision in order to obtain the best results and that burden may be most easily carried. The load is very heavy upon business, and particularly corporate business at present. Professional incomes are said to escape to a great extent and the share paid by agriculure is insignificant. The Figaro newspaper, whose financial page is accorded great respect in France, last year said:

> What should be demanded is that the base of the fiscal pyramid should be enlarged. The day when there are 3,000,000 persons subjected to income tax, instead of 900,000, the problem will be solved, and the Finance Minister who brings this about will be hailed as a financial genius. The proposal has often been mooted before, but no Government has yet had the courage to ignore the fact that the majority of the deputies represent agricultural constituencies, and dare not support this obvious reform unless they are prepared to lose their seats at the next elections. Yet therein lies the whole problem of French financial salvation.

France is pre-eminently an agricultural country, or has been in the past. The national wealth is estimated to be rather closely divided between that devoted to agriculture and that devoted to commerce and industry, although the latter now exceeds the former by perhaps 10 per cent, and is gaining. The national revenues derived from agriculture cut a very small figure. The income taxes are not levied at a uniform rate but vary with the schedules, and the budget for 1926 estimates the yield of the industrial and commercial profits tax at 1,950,000,000 francs and that from "agricultural profits" at 61,000,000 francs. In a recent report the Rapporteur General of Chamber of Deputies, who performs the function of expert adviser

to the Finance Committee, said that "the tax on agricultural profits has been scarcely collected at all," and added:

It is manifest that if all Frenchmen paid what they ought to pay, we should have a marvellous situation and the charges would be much lighter for all. It is fiscal evasion and dissimulation which oblige us to ask for so much.

Farmers are said to not pay income taxes very freely anywhere, even in the United States, and it must be considered that in France farming is an industry of very small units. Nevertheless cable reports state that Premier Poincaré's new tax bill which passed the finance committee of the Chamber of Deputies on July 29, carries an increase in the levy on agricultural profits from 7.20 to 12 per cent.

The railroad properties in which the State is largely interested and whose management it dominates are a drain on the Treasury which should be stopped. The telephone, telegraph, match and tobacco monopolies yield revenues, but in the opinion of competent judges are not advantageously handled.

Socialism has very little strength among the people living on the land in France, but it is easy to understand that when the deputies representing the farmers and the deputies (mostly socialists) representing the cities, sit down together to determine who shall pay the taxes, the industrialists and traders are in danger of not faring very well. Even if they are not to be relieved, perhaps some of the delinquents might be brought to make larger contributions.

The Floating Debt

The floating debt is the most uncertain element in the problem. It amounts to approximately 50,000,000,000 francs, including all maturities falling within one year. Obviously the Treasury cannot pay off all these obligations finally as they fall due, and it is equally obvious that there will be no need to do so if the holders have confidence in the Government and in the currency. From the standpoint of security, apparently nothing is gained by holding franc notes instead of government obligations payable in the notes, but the notes are legal tender and it is possible to convert them into tangible property so long as they pass current. Hence the danger that a state of alarm may cause maturing debt to be converted into currency.

If confidence is maintained, the present holders of these short obligations are likely to take renewals, for there is no supply of other investments to take their place. The credit situation is inflated and this is one of the forms in which the credit exists. The entire financial situation and the existing price level is adjusted to the present amount of circulating credit, and there would be a scarcity of ready forms of investment if this government paper was rapidly retired. The desirable treatment would be one similar to that which Secretary Mellon has given to the short debt of the United States by refunding it gradually into paper running for longer periods, with the maturities so distributed that no embarrassment is likely to result from them. This could be done here because there is full confidence in all forms of Government obligations and in the money. In France refunding operatoins of this kind are impossible while uncertainty exists as to the future value of the money.

This floating debt is a complicating factor in plans for stabilizing the currency because it may be rapidly converted into currency. Stabilization after inflation naturally produces a tight money situation unless the rate of stabilization is very high, for internal prices having lagged behind gold prices continue to rise until the international level is reached. With currency issues under control this tendency is favorable to the stabilization program, because it increases the demand for money, holds the outstanding currency in active use and makes it improbable that considerable amounts will be presented for redemption.

It is important, however, that the central bank of issue and redemption shall be the only source through which new supplies of currency may reach the public. It must be in command of the situation, and keep the money market sufficiently tight to prevent any redundancy, and to afford an inducement for capital to flow into the country instead of out, thus supporting the exchanges. A large floating debt which is constantly maturing menaces this control, for it affords the public a means of drawing currency from the Treasury to an indefinite extent.

It is understood that the floating debt of Belgium was one of the principal factors in the miscarriage of the stabilization plans of that country last Spring, and recent announcement in regard to further plans to that end have stated that the Belgian government will organize a private corporation to take over the state railroads and sell an issue of preferred stock to obtain funds to clear up the floating debt.

The French floating debt is too large to be paid off until it can be done by refunding operations. It must be carried by the French public and probably would be carried quite willingly if present apprehensions were allayed.

Restoration of Confidence

Everybody says that what is wanted is a restoration of confidence and obviously this is true, but confidence is not easily restored among millions of people once it is lost. One thing is certain, it cannot be restored without a change in the conditions by which it was lost. The pressure upon the franc in the ex-

changes has not been due to the foreign trade conditions or foreign manipulation, but to a feeling of uneasiness in France. The dissensions in parliament, the frequent change of ministries, the procession of finance ministers, the persistent budget deficits and resulting inflation, could have no other effect upon well-informed observers than the gradual wearing down of confidence. The dire results of inflation have been visible all around Europe.

There must be such a transformation of these conditions that the atmosphere of pessimism is changed. There must be unity in the Government upon one purpose, viz., to put an end to all financial disorder, by the adoption of policies which have the approval of non-partisan financial authorities. If the new ministry, representing practically all elements in the Government would unanimously adopt the program outlined by the Committee of Experts, it is possible that a decided impression upon public opinion would be made. There is reason to believe that an important amount of French capital is held abroad, which the owners will be glad to return to the country the moment they are satisfied that the monetary system is again on a sound basis. The stocks and bonds of French corporations have been depressed by the efforts of frightened holders to convert them into foreign issues, which is a condition favorable to a buying movement the moment there is assurance that industry is to have a firm base under it. This return movement of capital has been witnessed in Austria and Germany since those countries have obtained stable currencies. Moreover, as a further result of these monetary reforms foreign capital has gone to those countries in important sums and doubtless would go to France, if wanted, and if the monetary disorder was remedied. A movement of capital into the country would confirm and establish the success of the stabilization program.

Foreign Credits

Without doubt a program of reorganization or stabilization would make a stronger appeal to popular confidence if it included a provision for foreign credits, as proposed by the Committee of Experts, and as exemplified in several instances. The Chancellor of the British Exchequer in arranging for the resumption of gold payments thought it desirable to be able to announce that he was in command of credits in New York to the sum of $300,000,000, although he did not expect to use them and has not drawn on them to this day. The moral effect of such backing is very effective when a government is launching what for the moment may be regarded as something of an experiment. Unfortunately, the conditions at present are unfavorable to such an arrangement for France. One condition is that an important body of French opinion is opposed to foreign loans.

Although a foreign loan doubtless would do much to restore confidence in France, the first steps for the restoration of confidence must be taken in France and by the Government. There must be an end of uncertainty as to the Government's policies. A foreign loan would be serviceable only as a temporary aid; a situation must be created which is soon self-supporting, and it is not impossible that this may be done by France unaided. It is a question of unity in the national councils and confidence in the Government among the French people.

A New Monetary System

As indicated by figures above there is good basis for the opinion that at approximately its present exchange value the franc currency could be taken into a new monetary system, and stabilized upon the present gold reserves of the Bank of France, provided the Bank was starting anew and was assured of no embarrassing demands upon it by reason of its relations to the Government. It may be that the new Ministry will be able to inspire such confidence by its policies that the Government's creditors will be willing to renew their holdings of the floating debt, and that with increasing revenues provided by additional taxation, the Treasury may demonstrate its ability to meet its obligations without recourse to the Bank. If this is the case, exchange fluctuations should subside to proportions within the Bank's control, and it would be able to effect a gradual conversion of the old currency into a new issue for which it would assume the responsibility of redemption on demand.

If this should be impracticable the Bank may open a new department in which it will do business wholly on a gold basis, issuing a new currency, redeemable in gold. Gradually the business of the country would be transferred to the new basis. Foreign exchange operations would soon be conducted on the gold basis. There would remain the problems of dealing with the old currency and the old debts, public and private, which are payable in that currency, but by creating a new currency the Bank of France, which is primarily a commercial institution, would be able to escape from the overhanging liabilities of the Treasury, and on the basis of its ample gold reserve furnish the business interests of France with a sound currency.

It is indeed a very serious matter to alter in any way the money of a country, which is the basis of all contracts, including the public debt, but with the franc down from 19.3 cents to 2.5 cents in the market-place, it is too late to talk about saving it inviolate. It must be considered that the greater part of the value of the franc has been gone for years. Even

in the internal circulation it probably is not worth more than one-fifth of its pre-war value and this is all there has been any recent possibility of saving. The Committee of Experts has agreed unanimously that a readjustment of the value of the franc currency to gold is unavoidable.

The readjustment would be formal recognition of losses which have been suffered in the years that have gone since 1914. It is pathetic that the hard-working, self-denying, patriotic people of France, who have given their savings to the Government to defend and rebuild France should be compelled to accept these losses, but the obligations of the Government have become overwhelming and unmanageable, in the terms of the old currency. The losses through the depreciation of the money must be regarded as part of the cost of the war, and the losses, hardships and wrongs resulting from the war are confessedly beyond computation or redress.

Readjustment of the value of the currency necessitates a new currency, and since it must come, it would seem that the sooner it is available the better. It would be preferable to have the old currency immediately convertible into the new at a fixed rate of exchange, but if there is any question as to how much of the old may yet be issued, this would involve the new in the uncertainties of the old, which should not be.

The policy of creating a new currency independent of the old would not necessarily mean the complete repudiation of the old currency or old debts. It would mean that business would quickly have a sound currency with which to proceed, and that the value of the old currency and the terms of the old debt payments would be adjusted later. They present important questions, but not so important as that the business of the country shall go on and that the population shall be able to earn its daily bread.

Although the old mark currency of Germany became practically worthless, carrying all indebtedness with it, Germany has adopted a plan of revalorization, by which the old debts are given new validity to the extent of varying percentages of their former face value, running up to 25 per cent. In the case of the German State obligations these revived debts are necessarily subordinate to the reparation indebtedness, which makes the prospect for payments quite remote, but in the case of France no such complication would exist.

The French foreign loans in terms of other currencies will not be affected by changes in the monetary system of France.

The Wealth of France

The depreciation of the franc is not indicative of general conditions in France. The losses of individuals have been appalling, but there has been no corresponding loss of wealth to the country as a whole. In fact a great recovery of economic strength has occurred while the monetary depreciation has been going on. At the close of the war a large section of northern France was devastated and many of the most important industries were in ruins. So far as the industries are concerned the work of reconstruction is completed, and unquestionably they are more efficiently equipped and have larger capacity than before the war. The provinces of Alsace and Lorraine are again a part of France. In 1913 the iron and steel making capacity of France was much below that of England; now it is greater than England's. Industrially, France is a new nation. The cities make a fine showing of new buildings and many important public works are under way. The suburbs of Paris give the impression that a new city has encircled the old.

Whatever is done to the paper currency will affect none of these kinds of wealth. The lands, buildings, railways, docks, power houses, industrial equipment, and industrious population, all will be there, and they constitute the productive, debt-paying capacity of the country. They cannot be made productive, however, without a monetary system.

The country is not ruined, but embarrassed by a mass of pressing obligations and by the instability of its money.

The United States Debt Settlement

The people of the United States will regret that the debt settlement between the governments of France and the United States should be a factor in the present financial situation in France. The debts cannot be said to have been an active influence in producing the crisis, for with the exception of that for $400,000,000 on account of war supplies taken over in France they have not reached the stage of collection or even of appearance in the French budgets. The Treasury deficits have not been due to the foreign debts. Moreover, by the terms of settlement with this country now pending for ratification payments are fixed at very moderate sums over the next five years, with certain optional postponements. This concession was to allow time for the French Government to get its finances in order.

Nevertheless, it is true that this settlement has been one of the causes of dissension in the French Parliament and was a factor in the defeat of the Briand government. The opposition to ratification has been from the conservatives as well as socialists, Poincaré having been among the number said to be against it. Although protest is made against the size of the proposed payments, the opposition to ratification has been based upon two points, to wit: (1) the absence of the so-called "safety clause," under which the terms would be reconsidered

in the event of Germany's failing to make the reparation payments; (2) the presence of a clause authorizing the United States Government to sell the French obligations on the public market. The objection to sale has been that it would make any subsequent readjustment of the settlement impossible.

The Safety Clause

These matters are regarded in France as of great importance, for there is real anxiety over the financial situation. Amid their present perplexities, men who have the responsibility of action have misgivings about pledging the country to the proposed settlement unconditionally, the particular condition having reference to the receipt of reparations. It is fair to consider that they are dealing at the moment with a very difficult problem, and it is not to their discredit that they hesitate to commit the country to terms which they think possibly it may not be able to carry out.

The American Commissioners have regarded these points as of comparatively small importance in practical application, but they have made it a matter of principle that in general terms the debt settlements with all countries shall be alike. They have had to consider that ratification must be had by the American Congress as well as by the French Parliament, and that every special concession furnishes arguments to the opposition. The clause permitting the transfer of the debt to the public market could be hardly availed of unless France had become so prosperous that all doubts about the regularity of payments had disappeared, and money conditions were so easy that a low interest-bearing bond could be sold at par. In that situation France probably would have no objection to the transfer, and the "safety clause" would be superfluous. On the other hand, if the bonds are to remain in the United States Treasury, and a default should occur under the Dawes plan, the authorities of that time would be able to act in full knowledge of all conditions.*

Criticism of the United States

Concerning the new outburst of criticism of the United States we think it timely to repeat our opinion that the differing views upon the debts are naturally accounted for by the different viewpoints of the disputants. The people of Europe consider that the United States had the same interest in the war as they, and a great majority of the people of the United States do not think so. The people of this country are not unlike the people of Europe. If they did not come from Europe themselves, their parents did, or their ancestors not far removed. It is altogether probable that under similar conditions Europeans would react to the war situation just about as the people of this country did. Indeed it is easy for a traveler to observe that the European allies do not see everything from the same viewpoint. The French feel that if the British properly appreciated the sacrifices which France made for the common cause they would say nothing about debts and return the pledged gold to the Bank of France, while the British cannot help feeling that they are entitled to some gratitude for having crossed the Channel to get into a war which grew out of continental complications and which they might have kept out of. If they had been 100 miles from the continent instead of 30, more of them would have thought so, and if they had been as far away as the people of the Mississippi Valley they probably would have had about the same views as the latter.

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*NOTE—The agreement for the settlement of the French debt to Great Britain does not contain a safety clause, but the Finance Minister of France and Chancellor of the Exchequer of Great Britain exchanged notes upon the subject which are reproduced below. It does not appear that they modify the agreement, or convey any right to France which that country would not have under the agreement with the United States:

Mr. Caillaux's Letter

London, July 12, 1926.

Dear Mr. Churchill,—In assuming the responsibility of signing the agreement for the settlement of the French war debt to Great Britain, and thereby accepting the payment of the annuities fixed on the sole credit of France, I feel bound to explain that, in the opinion of the French Government, the future possibility of making payments and transfers across the exchange of the amounts required to assure the fulfilment of the debt settlements with the United States and Great Britain inevitably depends largely on the continued transfer of receipts from Germany under the Dawes Plan. If, therefore, for reasons outside the control of France, such receipts should cease completely or to an extent be greater than one-half, a new situation would be created, and the French Government reserves the right in such an event of asking the British Government to reconsider the question in the light of all the circumstances then prevailing.

It is subject to this express reservation that I am ready to sign the agreement which we have drawn up.

J. CAILLAUX.

The Chancellor's Reply

Treasury Chambers, July 12, 1926.

Dear Monsieur Caillaux,—I have received your letter of July 12. As I have explained His Majesty's Government must maintain the position that the settlement which we have arrived at of the French war debt to this country depends, like that debt itself, on the sole credit of France. You will realise that in the hypothetical circumstances that you mention Great Britain would already have suffered a diminution of the receipts from the Dawes Scheme, which we have taken into account in arriving at the various debt settlements, and this is one of the factors which would have to be borne in mind in the event of any reconsideration of the question being desired by the French Government. Subject to this I do not object to the statement that you make.

In the event of any modification being made I should expect, in order to secure equal treatment among creditors, that other creditors of France would take into consideration a corresponding modification of debts due to them.

Believe me, my dear M. Caillaux,

Yours sincerely,

WINSTON CHURCHILL.

Mr. Philip Snowden, spokesman of the Labor party in the House of Commons and recognized as a financial authority by reason of having served capably as Chancellor of the Exchequer in the Labor Government, recently devoted one - half of a very clever but bitter speech to berating the United States for their debt-collecting policy, and the other half to an equally scorching criticism of the present Chancellor of the Exchequer for his leniency toward the continental debtors of Great Britain, particulary France and Italy, which countries Mr. Snowden said could pay much more than they were being required to, if only they would order their finances correctly.

It is a curious circumstance, that all the European allies are agreed upon one proposition, viz: that it would be absolutely fair to have all the war debts mutually cancelled, and that they appear to be innocently incapable of understanding why the United States, the only country which is a creditor and not a debtor, does not see it in the same light.

No Transfer of Capital from Europe to America in Prospect

To these few reflections upon current criticism we would add the opinion that whether the debts are cancelled or kept alive, will in the long run make very much less difference to either the debtor or creditor countries than many people are thinking. It is agreed by all who have any competency for the discussion of the subject that the debts can be paid only in commodities or services, and none of the creditor countries have shown much inclination to accept payment by such means. Italy has paid $5,000,000 to the United States in the last year but borrowed more than $100,000,000 in the same time. The foreign loans of the United States in the first six months of 1926 aggregated $384,000,000, against $360,000,000 and $331,000,000 in the corresponding periods of 1925 and 1924 respectively. It will be a long time before the world is impoverished at this rate. The creditors of Germany on reparations account are discovering that the only way they can hope to make the full collections under the Dawes plan is by systematically organizing the importation of goods from Germany, but no such movement as that has developed in the United States, or is likely to.

There is not the slightest probability that the debts due the United States are going to cause a drain of capital from Europe. Great Britain is making payments, but not by transferring capital from Great Britain. She is paying with earnings which otherwise would increase her investments in other parts of the world. This capital serves to increase our investments abroad, and whether the titles to such newly invested wealth are held in this country or Great Britain, the benefits will be distributed throughout the world. It is a prime socialist belief that the benefits of wealth are confined to the owners; orthodox political economy teaches that all wealth productively employed is social wealth and that the benefits are inevitably distributed. In brief, economic conditions determine the distribution and use of capital, without much regard to where it may be owned, and the free play of economic forces may be expected to maintain the financial equilibrium of the world.

It hardly will be disputed that if reparations and debts could have been settled promptly after the establishment of peace, in a practical and judicial manner, with a view to restoring normal industrial and trade conditions over the world as rapidly as possible, the gains to creditor as well as debtor countries would have been very great. It may as well be recognized, however, that neither the populations nor the statesmen were ready for such a settlement or are ready yet. If they had had any such grasp of international relationships as this would imply there would have been no war.

New Clearing House Regulations

Amendments adopted during the past month to the constitution of the New York Clearing House are worthy of especial note on account of the elimination of the compulsory "exchange" charge for a long time levied on out-of-town checks, and because of the benefits accruing to banking and business generally through a speeding up of the banking machinery at this center. So tremendous have the financial operations here become, involving over $275,000,000,000 exchanges a year, that old methods have been outgrown, and new ones devised to carry the load of modern business requirements. For some time the banks have been adjusting themselves to the new conditions by informal arrangements wherever possible, but the need for a formal revision of Clearing House rules has been apparent, and the new amendments will definitely adapt the facilities of the Clearing House to the present day needs of both members and the public.

Elimination of "Exchange" Charges

Of chief interest to the public is the elimination of the "exchange" or "collection" charge on out-of-town checks. In view of the controversy which has existed over the policy inaugurated by the Reserve banks of establishing check collections at par throughout the country, it may be of interest to explain the origin of this charge and the difference between it and a charge imposed by a bank upon a check drawn on itself. In earlier years it was the usual practice for persons desiring to make payments at a distance to procure from

a local bank a draft drawn on a correspondent bank in one of the central cities of the country. Drafts drawn on New York were an acceptable means of payment anywhere in the country. This practice required the local banker to carry balances with the city correspondent on whom he drew and involved him in whatever costs there were in maintaining the balance, drawing drafts, etc. Of course, he made a charge for the service, and these exchange charges on domestic remittances were an important item in the revenues of the country banks. The business naturally adjusted itself in development and operating expenses to this source of revenue. In this system of remittances the banks of New York, Chicago and other cities on whom this great volume of drafts was drawn were playing the passive part of paying drafts drawn against funds in their possession. They received no exchange charges on such drafts, and were at no special expense. The active part of the services was performed by the local banks supplying the drafts.

Origin of Exchange Charges on Checks

Gradually, as banking service developed and became more commonly used by the public, personal checks began to be used instead of drafts for payments sent to any part of the country, and it is significant of the manner in which the development of means of communication has made the country one community, that the personal check has generally displaced the bank draft for domestic remittances.

This change, while evidently serving the convenience of the public, was unwelcome to the bankers of both city and country. The bankers of New York, instead of simply receiving and paying drafts drawn on themselves, now received from their depositors a mass of personal checks drawn by persons to them unknown, on country banks in all parts of the country, with most of whom they had no regular banking relations. They accepted the checks upon the endorsements, but were put to the trouble of collecting them, which involved expense and delay in obtaining cash funds. Meantime, in pursuance of banking practice the depositors of these checks received immediate credit in their bank accounts. Obviously, the change from the draft to the check as means of remittance was very disadvantageous to the New York banks. Nor was the subject an easy one to deal with, for the imposition of any charge, to cover the cost of handling the checks was certain to divert banking business away from New York City. Nevertheless, after much deliberation the New York Clearing House decided that it was necessary to adopt rules for uniform practice in handling "out-of-town" checks and requiring the imposition of a reasonable charge. The result, as expected, was a considerable diversion of deposits to other cities, business houses accustomed to receive many country checks opening bank accounts in other cities as a means of handling them.

This action was the more necessary because of the policy adopted by the interior banks of imposing exchange charges for remittances covering checks drawn on themselves. Although no longer called upon to draw drafts, they were still playing a part in the system of payments, still obliged to remit to the centers to cover the checks drawn on them, and naturally they were unwilling to relinquish exchange as a source of income. They imposed charges upon the checks, which became a new expense upon the collecting banks of New York and elsewhere. In New York the burden became so serious that it finally became the decisive factor in the action by which an exchange charge was levied and deducted from the proceeds of each out-of-town check.

Establishment of Par Collections

As a result of the facilities for the collection and payment of checks afforded by the Federal reserve banks, and of their efforts to establish free currency for checks throughout the country, the practice of banks in charging exchange on checks drawn on themselves has been generally done away with, approximately 90 per cent of the banks of the country now remitting upon such checks at par. It is not the purpose of this discussion to go into the merits of that controverted subject, except to show how the charge originated, and to say that its abandonment involved the loss of an important source of revenue to many country banks, and was the subject of earnest protests on their part. While it involved such losses, there is reason to believe that the business will adjust itself to the new conditions so that the net results of banking service will not be impaired. The amount of competition—the extent to which the field is divided by competitive units—is an important factor in banking as in other lines of business, and the exchange charge probably was a factor in the multiplication of local banks. A sudden change of methods in any line of business is likely to involve temporary losses, which have to be accepted if they result in general benefits. It cannot be questioned that the method of handling checks has been much improved over what it was before the Federal Reserve authorities undertook to bring order out of the existing confusion. Whatever improves banking service to the public will prove beneficial to the banking business in the long run. Every business must adapt itself to that principle.

Other Bases for Exchange Charges at New York

The charge imposed by country banks upon their own checks was not the only basis of the

exchange charge placed by the New York banks upon "out-of-town" checks, but it was one of the important conditions prompting its establishment, and its removal resulted in bringing the subject up for reconsideration. One justification remains, to-wit: that banks here do not receive credit at the Reserve bank on checks forwarded for collection until return remittances are received, which means that if a depositor is given immediate credit, as has been generally the case, the bank is really "out" funds for the period during which the check is in process of collection. The collection charge therefore, while originally levied to include the exchange exacted by the country banks, has come to be more of an interest charge to cover what is really a temporary loan to the depositor. This charge, hitherto obligatory for Clearing House members, is now made discretionary, and in all probability will be abolished by most—if not all—the members, except in case of checks on the relatively few banks that do not remit at par.

Advantages of the New System

Henceforward, in lieu of the interest charge, the rule will be for banks receiving out-of-town checks on deposit to defer giving credit until such checks can be forwarded for collection and settlement received in Federal reserve funds: Thus by an adjustment of the time of giving credit to conform with the Feredal reserve schedules, the chief remaining reason for the collection charge is done away with. This, of course, applies only to checks left on deposit, as where checks are cashed and the proceeds immediately withdrawn, banks here will continue to lose the use of funds pending their collection.

In general, the advantages of this new procedure may be summarized briefly as follows:

(1) It enables the banks, without loss to themselves, to do away with a charge which has undoubtedly been a source of irritation to the public.

(2) It establishes a uniform practice for the handling of out-of-town checks. Heretofore the procedure has not been uniform, and some banks have taken checks without giving immediate credit, and have made a charge for handling in addition.

(3) It gives opportunity for bad checks to be discovered before credit is given and the proceeds are drawn against.

(4) It removes a source of much confusion in the public mind regarding par collections. The difference between the interest charge and the old time exchange charge has never been generally understood, and many people express surprise that they have to stand a charge on out-of-town checks when they have understood that such charges had been done away with by par collections. The doing away with all charges will clarify the situation, and aid in the establishment of par collections on a firm basis.

(5) From the viewpoint of the more immediate advantage of the Clearing House members themselves, it puts them on a competitive basis with certain non-Clearing House banks which have been offering free collection services, and should in addition enable Clearing House members to draw enough business from out-of-town to offset any expense in handling outside checks.

Of approximately 300 clearing houses throughout the country, only about 25 require their members to make any charge for collecting out-of-town checks, so that the action of the New York Clearing House represents merely a falling into line with what has been generally accepted practice elsewhere.

Other Changes

One of the most important of the other changes provides for a night settlement at 2.00 A. M. of all items received after the regular 10.00 A. M. clearing, thus distributing more equably the load which has heretofore fallen on the regular morning clearing. Other amendments relate to the zoning of the city to facilitate the return of "not good" items; the establishment of an optional exchange at the Clearing House for clearing of coupons; authorization of the Clearing House Committee to fix maximum interest rates from time to time, except as to special interest accounts, of which the maximum is now raised from $10,000 to $15,000; and abolition of the phrase "Payable only through the New York Clearing House" and like phrases on drafts drawn against Clearing House members, thus making possible settlements outside of the regular exchanges wherever desirable. All of which is in the direction of increased efficiency and a modernization of Clearing House practice that will benefit banks and business alike.